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TESSCO Technologies, Inc. (TESS)

Q1 2019 Earnings Call

CORPORATE PARTICIPANTS

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Aric M. Spitulnik
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OTHER PARTICIPANTS

Marc Wiesenberger
Analyst, B. Riley FBR, Inc.

William Joseph Dezellem
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the First Quarter 2019 TESSCO Technologies Incorporated Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to our host for today, Andrew Blazier with Sharon Merrill Associates. You may begin.

Andrew A. Blazier
Senior Associate, Sharon Merrill Associates, Inc.

Good morning, everyone, and thank you for joining TESSCO's Q1 2019 conference call. Joining me today are Murray Wright, TESSCO's President and Chief Executive Officer; and Aric Spitulnik, the company's CFO. Please note that management's discussions today will contain forward-looking statements about anticipated results and future prospects. Forward-looking statements involve a number of risks and uncertainties, and TESSCO's results may differ materially from those discussed today.

Information concerning factors that may cause such a difference can be found in TESSCO's public disclosures, including the company's most recent Form 10-K and other periodic reports filed with the Securities and Exchange Commission. Please note that management's discussions today – with that introduction, I'd like to turn the call over to Murray Wright, TESSCO's President and CEO. Murray?

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

Thank you, Andrew, and good morning, everyone. Thank you for joining us on the call today. We continued our recent trend of strong growth in revenue and earnings during the first quarter, as we again demonstrated solid execution on our strategic plan. We achieved first quarter revenue growth of 8%, marking the sixth time in the past seven quarters we produced year-over-year growth.

On the bottom line, earnings per share of $0.13 improved 63% from the year-ago quarter, reflecting our improved operating leverage even as we made strategic investments in inventory, marketing and technology to drive future growth. From a top line perspective, revenue in our commercial markets grew 16%, including an impressive 52% increase in the carrier ecosystem.

Our continued success with recent carrier customer relationships has enabled us to grow our market share. This is a critical point, as TESSCO is increasing carrier ecosystem sales at a strong double-digit rate, even as many analysts anticipate wireless CapEx expansion in the public carrier space will only increase approximately 5% this year.

As anticipated, our work with MasTec has yielded substantial growth, and we are working aggressively with MasTec and our vendor partners to continually enhance the supply chain performance. While we have increased our market share with Verizon's general contractors and are performing extremely well with direct sales to Verizon corporate, we believe there are still significant growth opportunities in these relationships.

We also have a strong market presence with other carrier customers, OEMs and contractors beyond Verizon and MasTec. And as carriers begin to increase their activity levels, we expect to see additional revenue growth. We are well positioned as the first responders network or FirstNet project continues and 5G buildouts begin later this year.

Turning to the retail market, as expected in Q1, sales declined 8% year-over-year primarily as a result of the earlier launch of the Samsung Galaxy S9. This year's launch occurred in March, so those sales were primarily in our fourth quarter, while last year the launch occurred during our first quarter. Even with the resulting year-over-year difficult comparison, our team grew our market share and cultivated new opportunities through intense focus on business development and collaboration with our manufacturer partners.

As you know, the retail space is very dynamic. We expect to see continued customer consolidation in the independent dealer channel, although at a much slower pace than what we experienced in fiscal 2018. And we anticipate growth from the new channels and new customers, including increasing sales to commercial accounts. We attribute our continued overall revenue growth to the implementation of our go-to-market strategy, which we launched last year, and our improved execution. We believe this will help us position us for growth in the future.

As we have mentioned previously, we are launching an effort to sell services as a product to our customers, leveraging our core competencies in supply chain and retail services. We expect this focus will lead to greater recurring revenue, margin contribution and improved customer satisfaction. In supply chain services, we're planning to leverage our continuous investment in systems and people and share those strengths amongst our customers and vendors.

Each of these supply chain services require a consultative approach to developing a customized solution to enable our customers to achieve their precise objectives. We're offering services such as supply planning, transportation management, warehousing, value-added services such as kitting, bundling and labeling, reverse logistics, demand planning, and office functions such as invoicing and collections.

In retail services, we are using – utilizing our extensive market knowledge to improve the customer experience at the point-of-sale and drive increased accessory sales. A key differentiator for us in this space will be to create an exceptional in-store experience using multiple methods such as digital and sales-driven techniques to satisfy customer needs. Our retail services offer includes merchandising, training, data and analytics, store compliance, omni-channel, execution and vendor-managed inventory programs. We'll have more to discuss with you in the future, as these new initiatives develop and progress.

As we have previously discussed, we are re-energizing our VAR business. The regionalization of our entire sales organization is enabling us to build a solid ecosystem for our end-user communication networks, while providing lead referrals to our VAR community. We are working closely with our broadband manufacturers to forecast inventory and reinforce our reputation as a key provider of broadband solutions.

Additionally, we will – we have seen growth in DAS product sales, as we believe DAS solutions will continue to grow. We are upgrading our capabilities in digital engagement to enable us to further grow our business with vendors, regional VARs and very large VARs. And as we have mentioned before, we continue to invest in our IoT business and we are seeing traction from our efforts.

Before I hand the call over to Aric, I want to emphasize a few key points. First, our solid performance in the first quarter extended our trend of year-over-year growth in revenue and earnings. This growth is the direct result of company-wide dedication and execution of our strategic plan. Second, the initiatives we put in place during the past year and the technology, marketing and sales efforts we've been making are delivering the results we expect. Our new initiatives and the good work of our – our team has done to improve our focus on the customer experience has established a firm foundation for future growth.

Finally, we remain focused on balancing our sales and marketing efforts with increased operating efficiency. We know that we still have work to do, but we like the progress. As a result of higher carrier activity throughout this calendar year, as well as anticipated growth across the commercial and retail business, we expect accelerated growth in revenue and profitability during the remainder of fiscal 2019. We are confident in our plan and our team, and we look forward to discussing additional successes on our next quarterly update and throughout the fiscal year.

And now, I'd like to turn the call over to Aric for a discussion of the financial results. Aric?

Aric M. Spitulnik

Chief Financial Officer, Senior Vice President, Corporate Secretary & Principal Financial and Accounting Officer, TESSCO Technologies, Inc.

Thank you, Murray. Good morning, everyone. For the first quarter, revenues totaled $151 million, up 8% [audio gap] (00:08:56) quarter. The increase in revenue was driven primarily by our public carrier market and to a lesser extent by higher sales in the private system operator and government markets. Gross profit for the quarter increased by 5% from a year ago to $31 million due to higher revenues. Gross margin for the quarter was 20.3% compared with the 20.8% a year ago. This margin decline is primarily a function of increased sales to large key customers in the carrier ecosystem.

SG&A expenses increased 4% to $29 million due to greater investments in marketing and technology and higher than usual health insurance costs. However, these increases were partially offset by lower compensation and improved efficiency in freight costs. Because of our ongoing expense control initiatives and productivity enhancements, the increase in SG&A expenses for the quarter was lower than the growth in revenue and gross profit. As a percentage of revenue, SG&A was 19.2% compared with 19.9% of revenue in the first quarter of fiscal 2018.

Given the combination of increased revenue and our effective expense control, our operating income increased to $1.7 million or 1.2% of revenue from $1.3 million or 0.9% of revenue a year ago. We anticipate revenue growth in future quarters, and we believe that will result in improved operating margins. Net income for the first quarter increased to $1.2 million from $0.7 million a year ago. Earnings per share rose 63% to $0.13.

Now, turning to the balance sheet, as we expected, during the first quarter, inventory grew to support the increase in our carrier business and we also experienced a corresponding increase in accounts receivable. While growth in the carrier business inherently puts pressure on inventory and receivables, our entire organization is focused on improving these measures, and we expect to see faster turns as we move throughout the year.

Finally, we remain committed to our dividend program and have set our dividend at $0.20 per share with a record date of August 1 and a payment date of August 15. While we are not providing numerical guidance, we currently anticipate year-over-year growth in revenue and profitability in both the second quarter and fiscal 2019. We expect considerable growth in the carrier ecosystem, although this growth should result in lower overall year-over-year gross margins, given the lower margin nature of many of these large relationships.

Also, keep in mind that due to the project-oriented nature of many of these larger customers, we expect to see some fluctuation in the quarter-to-quarter results. As we look to the remainder of fiscal 2019, we are excited about our progress and the results we are delivering across the business. We look forward to providing additional updates on future calls.

And with that, operator, we will open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Marc Wiesenberger of FBR. Your line is now open.

Marc Wiesenberger
Analyst, B. Riley FBR, Inc. Q

Thank you very much. Good morning. In Q1, some other partners with Verizon noted that they were a little slower with releasing their budget and that impacted some of the business. Have you noticed that they have kind of gone back to business as usual with their spending from earlier levels in the year?

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc. A

Marc, that's an interesting question. I think that our team is engaged extremely well with the Verizon team and we've got a number of initiatives. So, I'm not – I don't think that the budget impact from Verizon's perspective has really impacted our engagement levels with Verizon.

Marc Wiesenberger
Analyst, B. Riley FBR, Inc. Q

Okay, great. Thank you. Another question. Can you talk about the Sprint and T-Mobile merger and how you expect that to impact the business going forward?

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

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Well, we got quite a few questions about that on the last call. And I think that – I think they've still got a few hurdles to overcome, right, from the Justice Department and so on. But both of the companies are customers of ours. We are engaged as business as usual, and I can tell you that both organizations seem to be very focused on that. And right now, that's what we're working on is making sure we're providing good execution and a good experience for any of the business that we do with Sprint or T-Mobile.

Marc Wiesenberger
Analyst, B. Riley FBR, Inc.

Q

Great. Thank you. And last one, are you seeing any inflationary pressures currently or potentially on the horizon that you expect to impact the business? And then, I'll leave it there. Thank you.

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

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Yeah. The only thing would be perhaps not knowing what the outcome of tariffs will be, and we're just starting to get our arms around that. And as you're probably aware, there's more and more information that's being released on applying for exemptions and what products are impacted by tariffs. So, we're just getting into that right now, but that's the only thing I can think of.

Operator: Thank you. [Operator Instructions] Our next question comes from Bill Dezellem of Tieton Capital. Your line is now open.

William Joseph Dezellem
Chief Investment Officer & President, Tieton Capital Management LLC

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All right, thank you. A couple of questions here. First of all, would you please discuss your comments relative to IoT gaining traction?

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

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Sure. Absolutely, Bill. I think we've made statements in the past that it's an emerging market. We believe that TESSCO has had a solution [ph] it offers (00:15:14) for the IoT market for quite some time, and we've expanded vendor relationships to enhance our portfolio of solutions that we can offer to the marketplace. So, recent vendor relationships that are being enhanced with Sierra Wireless and Monnit are examples, where we're selling sensors and modules, and we're working with one carrier in particular on solutions that are IoT focused and kind of customized out-of-the-box solutions for IoT. So, we think that we've got a good answer there, Bill, for the IoT market and we'll participate in the growth opportunities that exist.

William Joseph Dezellem
Chief Investment Officer & President, Tieton Capital Management LLC

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Thank you. And in the press release, you referenced multiple quarters of growth and growth for the full-year. Am I correct in remembering that this is the first time that you have referenced growth beyond one quarter? And it seems as though previously you've been holding your forecast reasonably close to the vest. Are you expanding your comfort level, and if that's the case, would you dive into that in more detail also, please?

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

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Well, I think we've – as you know, Bill, we went through quite a bit of strategic change last year and we implemented a lot of change, and I think the company demonstrated that we can change and grow at the same time. The initiatives that we put in place are starting to gain traction, and being able to compete effectively, provide the value proposition and improved customer experience is starting to gain some traction.

And as I mentioned just in the call here, we still have work to do. But we feel that with the efforts from our team and how we're positioned in the marketplace, we feel pretty confident being able to share with our investors and potential investors that there is a pathway to growth that will accelerate over the next many quarters and perhaps over the next couple of years, and we want to give you more of a comfort level that there is a direction that we are pursuing that's beyond just the next quarter.

William Joseph Dezellem
Chief Investment Officer & President, Tieton Capital Management LLC

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Great. Thank you, Murray. I'll step back in and re-queue up.

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

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Okay, thank you.

Operator: Thank you. And ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to Murray Wright for any closing remarks.

Murray Wright
President, Chief Executive Officer & Director, TESSCO Technologies, Inc.

All right. Well, thank you, Sonia, and thank you to everyone for joining us. We appreciate your support of TESSCO, and I also wanted to just end the call by thanking our team members for their continued hard work and dedication. Have a great day. We'll look forward to talking to you again soon.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.